

TO: State Directors  
Rural Development

ATTN: Multi-Family Housing Program Directors  
Real Estate Appraisers

FROM: James C. Alsop  
Acting Administrator  
Rural Housing Service

SUBJECT: Appraising Multi-Family Housing Properties

**PURPOSE/INTENDED OUTCOME:**

The purpose of this Administrative Notice (AN) is to provide guidance on Multi-Family Housing appraisal policies, comply with current government-wide appraisal policies and Agency lending practices.

**COMPARISON WITH PERVIOUS ANs:**

No previous AN has been issued on these topics.

**BACKGROUND:**

The Office of Management and Budget (OMB) Circular A-129 stipulates that all credit transactions over \$100,000 will have an appraisal prepared by a State licensed or certified appraiser. Furthermore, Agencies shall require all appraisals to be consistent with the Uniform Standards of Professional Appraisal Practice (USPAP). RD Instruction 1944-E recommends the practice of utilizing other sources of funding (leveraging) when financing 515 construction. The adoption of USPAP and leveraged lending has generated several questions regarding appraisals in the Rural Rental Housing loan programs. The use of appropriate appraisal methodology is especially critical for properties that involve multiple funding and financing sources. Example: RD provides a portion of the financing (50 percent), State Housing Financing Agency provides a portion of the financing (HOME funds) (20 percent), and the developer makes a substantial equity contribution from tax credit revenues (30 percent). Consequently, it is essential for the appraiser to thoroughly understand the financing and its effect on value.

EXPIRATION DATE: April 30, 2002

FILING INSTRUCTIONS:  
Preceding RD  
Instruction 1922-B

The appraiser must know all sources of financing, the terms and conditions of these other sources, whether other financing sources contain restrictive-use clauses and if the restrictive-use clauses are durable (recorded in the deed) or are non-durable (a condition of financing which is not recorded in the deed).

This AN provides explanations and examples that will enable staff appraisers to appropriately apply and comply with OMB's government-wide appraisal policies and Agency appraisal policies.

### **IMPLEMENTATION RESPONSIBILITIES:**

The terms and conditions of financing have a significant impact on real estate value, the appropriate appraisal format and the definition of value being sought. Consequently, it is the Program Manager's responsibility to meet with the appraiser and explain the terms and conditions of financing for each appraisal request and provide applicable documentation from the proposal's file, such as copies of the deed, survey, flood plain map, environmental assessment, market study, site plat, plans and specifications, description of the proposal, and the Sources and Uses Comprehensive Evaluation (SAUCE) report. It is the Agency's responsibility to provide the appraiser with the purpose of the appraisal, the intended use and intended users of the report, and the value definition being sought: market-value, value-in-use or liquidation (quick-sale) value.

#### **1. Multiple sources of financing:**

When multiple financing sources are involved, the appraisal report should contain a narrative identifying each source of financing, the amount of financing and the rates and terms of each portion of the financing including security requirements. The financing narrative should address how each source of financing affects value and how each source of financing relates to making the proposal feasible. In the income approach, a capitalization rate can be developed that reflects the varied sources of financing and their impact on the capitalization rate.

#### **Capitalization Rate Documentation:**

To identify the source of funds and for obtaining a capitalization rate, the preferred method is through the development of a capitalization rate using a band-of-investment formula.

Example:

<u>Funding Source</u>	<u>Amount of Financing</u>		<u>Individualized Cost of Funds</u>	<u>Individual Cap Rate</u>
Mortgagee	. 50	X	Amortization factor	= A
	Plus			
Secondary Mortgagee	. 20	X	Amortization factor	= B
	Plus			
Third Source Funds	. 10	X	Grant from some source (no factor)	= C
	Plus			
Owners Equity	. 20	X	Annualized required return on equity	= D

Capitalization Rate Reflecting Overall Cost of All Funds = A+B+C+D

When a specific investment's individualized capitalization rate is developed, it is to be compared to capitalization rates of other investments with similar risk and documented in the appraisal report. Other appropriate value indicators are: gross rent multipliers (GRM), capitalization rates extracted from sales, institutional investor yield rates for similar investments from Government National Mortgage Association (Ginnie Mae) or Federal National Mortgage Association (Fannie Mae), a rate developed using a build-up model, and the mortgage equity band of investment model for the specific subject market.

## 2. Purpose of appraisal and value definition:

The Uniform Standards of Professional Appraisal Practice 2000, available from The Appraisal Foundation, P.O. Box 96734, Washington, D.C. 20090-6734, stipulate that every real estate appraisal will state the purpose and intended use of the report. The purpose should be defined as establishing an estimate of "market value, "value-in-use, or "liquidation (quick sale) value ", and whether the use is for the internal underwriting, internal servicing or internal asset management decision-making process.

A. An acceptable definition of Market Value is: "the amount in cash, or terms reasonably equivalent to cash, for which in all probability the property would be sold by a knowledgeable owner willing but not obligated to sell to a knowledgeable purchaser who desires but is not obligated to buy". "The definition for market value published in USPAP is also an appropriate definition for market value.

B. An acceptable definition of Value-In-Use is the above definition supplemented with the following language: "and considers any rent subsidies, tax credits, tax rebates, grant funds or terms of financial arrangements equivalent to cash associated with the housing, including restrictive-use conditions or covenants imposed by a government or non-government financing source."

### **3. Appraisal Format:**

Requests have been received to use a narrative appraisal format in lieu of the Agency form report (Form RD 1922-8). The use of a narrative report is acceptable provided it complies with the requirements of USPAP and Agency appraisal policies, and this type of appraisal format is offered to all fee appraisers. Other acceptable automated form appraisal reports are FNMA 71-A and the Uniform Commercial Industrial Appraisal Report (UCIAR). These automated reports are available in the Appraiser's Choice Incorporated (ACI) appraisal software provided by the Agency.

### **4. Determining the Holding Period and Discounting Methodology:**

Determining the holding period for use in the discounting process has generated much discussion. Currently there are adequate sales of subsidized housing within each state to establish a supportable holding period (when a change of ownership occurs) that is specific to a subsidized portfolio and unique to your region (state). In no instance is it conceivable that the holding period could exceed the term of the loan: 30 years for the 515 loans and 33 years for the Farm Labor loans. The program director is responsible for establishing data to be used to determine the holding period for their region (state) and this data is to be provided to the appraiser as a part of the appraisal request.

#### **A. Determining Net Operating Income (NOI):**

Another topic that has generated vigorous debate is the appropriate methodology for valuing the net operating income (NOI). Subsidized real estate operates in a more regulated environment than conventional real estate. Consequently, rents, holding periods, rates of return and rent increases are more predictable. For subsidized housing the recommended income valuing methodology is the use of a discounted cash flow (DCF) analysis or the use of a model that employs the DCF methodology. Discussion on the use of this methodology can be found in USPAP 2000, Statement on Appraisal Standards No. 2.

#### **B. Restrictive-use Covenants:**

Regardless of the format used, the appraisal is to identify and discuss the restrictive-use covenants and whether they impact the value of the property. Typically, restrictive-use covenants exist in two forms: (1) Non-durable restrictive use covenants that are conditions of financing but are not recorded as a permanent restriction on the real property. (2) Durable restrictive use covenants which are recorded with the real property deed and will transfer with the property. Durable restrictions will be sustained even through the foreclosure process. This type of restrictive-use is typically filed by a State Financing Housing Agency and is a routine practice of the tax credit program. Either type of restriction is to be fully disclosed in the appraisal and the appraisal should document whether the restriction impacts the value of the real estate.

## **5. Appraisal Administrative Issues:**

### **A. Release of appraisals:**

Rural Rental Housing (RRH) appraisals are procured by the Agency to be used in the Agency's internal decision making process and are for use in subsidized financing only. Consequently, the Agency retains sole ownership of this internal decision making document and will not release an appraisal for purposes unrelated to the purpose for which the appraisal was obtained.

### **B. Appeal of appraisals:**

RRH appraisals are procured by the Agency for internal decision making purposes and is only one document used in a complex decision making process. It is the Agency's position that although decisions based upon these appraisals are appealable the appraisal itself is not appealable. However, all RRH appraisals are reviewable. An applicant or borrower requesting a review of a RRH appraisal is to submit their written request to the National Office Multi-Family Loan Division. The request should identify the specific appraisal and specify their reasons for requesting a review.

### **C. Ownership history:**

All RRH appraisals are to contain a minimum of a 5-year ownership history of the real estate being appraised.

### **D. Contracting for appraisal services:**

The practice of contracting for RRH appraisals is encouraged whenever possible and appropriate.

Any questions should be directed to Steven D. Jorgensen of the Multi-Family Housing Processing Division at (202) 720-1604.